

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Braka & Co., Inc. :
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Corporation :
Franchise Tax under Article 9A of the Tax Law for :
the Years 1972 & 1973. :
AFFIDAVIT OF MAILING

State of New York }
ss.:
County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 6th day of July, 1984, he served the within notice of Decision by certified mail upon Seymour Taub, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Seymour Taub
Eisner & Lubin
250 Park Ave.
New York, NY 10017

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
6th day of July, 1984.

David Parchuck

James A. Hagedorn
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

July 6, 1984

Braka & Co., Inc.
c/o David Braka, Pres.
450 Seventh Ave.
New York, NY 10001

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1090 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Seymour Taub
Eisner & Lubin
250 Park Ave.
New York, NY 10017
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

| | | |
|---|---|----------|
| In the Matter of the Petition | : | |
| | : | |
| of | : | |
| | : | |
| BRAKA & CO., INC. | : | DECISION |
| | : | |
| for Redetermination of a Deficiency or | : | |
| for Refund of Franchise Tax on Business | : | |
| Corporations under Article 9-A of the | : | |
| Tax Law for the Years 1972 and 1973. | : | |

Petitioner, Braka & Co., Inc., 450 Seventh Avenue, New York, New York 10001, filed a petition for redetermination of a deficiency or for refund of franchise tax on business corporations under Article 9-A of the Tax Law for the years 1972 and 1973 (File No. 27930).

A formal hearing was held before Doris E. Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on January 29, 1982 at 9:00 A.M. Petitioner appeared by Eisner & Lubin (Seymour Taub, C.P.A.). The Audit Division appeared by Paul B. Coburn, Esq. (Irwin Levy, Esq., of counsel).

ISSUE

Whether the Audit Division properly disallowed a portion of petitioner's interest expense as indirectly attributable to subsidiary capital.

FINDINGS OF FACT

1. On November 11, 1975, the Audit Division issued to petitioner, Braka & Co., Inc. ("Braka"), two Notices of Deficiency, asserting additional franchise taxes due under Article 9-A of the Tax Law for the years 1972 and 1973 in the respective amounts of \$1,519.33 and \$2,364.84, plus interest. The basis of the adjustments was an indirect attribution of petitioner's interest expense to

subsidiary capital. The Audit Division calculated the disallowed portion of petitioner's interest deduction by multiplying its total interest expense by the following ratio: value of subsidiary capital (Schedule C, line 1)/value of total assets (Schedule E, line 1). The Audit Division utilized the average fair market value of assets as shown by petitioner on its franchise tax reports.

2. In February, 1971, Braka acquired 100 percent of the voting stock of Midland Credit Corp. ("Midland") in a transfer pursuant to section 351 of the Internal Revenue Code. Braka contributed to Midland \$44,284.00 in cash (from Braka's treasury) and \$455,716.00 in interest-bearing notes. At all relevant times, Braka's equity, retained earnings and capitalization exceeded Midland's capitalization.

3. Both corporations are engaged in the business of purchasing notes of foreign makers and re-selling them to investors. Each corporation has its own portfolio of investments and its own sources of financing for such investments.

In 1972 Midland incurred interest expenses in the amount of \$121,136.00. In 1972 and 1973 Braka incurred interest expenses of \$87,652.00 and \$98,776.00, respectively.

4. Midland paid no dividends to its sole shareholder, Braka.

5. On its 1973 federal income tax return, Braka reflected liabilities totaling \$163,658.00, which amount encompassed a liability of \$37,799.00 to Midland. Braka had also been indebted to its subsidiary in the previous year.

6. On or about January 13, 1976, Braka filed petitions requesting redetermination of the deficiencies for 1972 and 1973, stating the following ground therefor:

"Taxpayer pays interest on loans incurred in the ordinary course of its business. The interest paid on these loans should be fully deductible and not attributable to subsidiary capital. No loans are incurred for the purpose of investing in subsidiaries."

On May 20, 1976, the Audit Division requested further information from Braka, including: (1) each asset to which interest expense was directly attributed, the amount of the interest expense, and the nature, date and amount of liability incurred to acquire or maintain the asset; (2) the date Midland was acquired and how such acquisition was financed; and (3) the average amount of loans and advances to Midland.

On June 18, 1976, petitioner's representatives advised the Audit Division that they were assembling the data necessary to respond to the above questions. Petitioner never submitted the data nor did the Audit Division pursue its request.

7. On or about June 28, 1976, petitioner filed a Claim for Credit or Refund of Corporation Tax Paid for the year 1973 in the amount of \$337.00, founded upon the carryback of a 1975 net operating loss; on or about November 29, 1976, petitioner filed a similar claim for the year 1972, seeking a refund in the amount of \$601.00.

CONCLUSIONS OF LAW

A. That Tax Law section 208, subdivision 9 furnishes the definition for and method of computing entire net income; paragraph (a), subparagraph (1) thereof provides that entire net income shall not include "income, gains and losses from subsidiary capital...". Paragraph (b) sets forth those exclusions, deductions and credits which are not permitted in the determination of entire net income and provides, in pertinent part:

"Entire net income shall be determined without the exclusion, deduction or credit of:

* * *

(6) in the discretion of the tax commission, any amount of interest directly or indirectly and any other amount directly attributable as a carrying charge or otherwise to subsidiary capital or to income, gains or losses from subsidiary capital."

The regulation in force for years prior to 1976 addressed the above two provisions as follows:

"After determining Federal taxable income, it must be adjusted as follows:

* * *

Deduct from Federal taxable income:

(8) All dividends, interest and gains from subsidiary capital...which were taken into account in computing Federal taxable income (less, in the discretion of the State Tax Commission, any deductions allowed in computing Federal taxable income for (1) interest which was directly or indirectly attributable, and (2) any other amounts which were directly attributable, as a carrying charge or otherwise, to subsidiary capital or to income and gains therefrom), but not any other income from subsidiaries...". Former 20 NYCRR 3.11(b).

B. That petitioner gave cash and notes in exchange for the stock of Midland, which notes petitioner had earlier acquired as business assets through financing. In the absence of any evidence directly attributing petitioner's interest expenses for 1972 and 1973 to business capital, it is entirely reasonable to conclude that a portion of such expenses was paid upon the financing undertaken to purchase the notes contributed to Midland; therefore, that portion of the interest expenses was attributable to subsidiary capital.

C. That the Commission does not choose to exercise the discretion accorded to it under Tax Law section 208.9(b)(6) to allow petitioner a deduction for the amount of interest indirectly attributed to subsidiary capital. The taxpayer's exclusion of income from subsidiary capital is not a prerequisite to the disallowance, in the same taxable year, of the interest deduction. To conclude otherwise would allow taxpayers, via the appropriate timing of distributions to parent corporations from subsidiaries, to avoid taxation on such distributions, while at the same time taking advantage of the interest deduction.

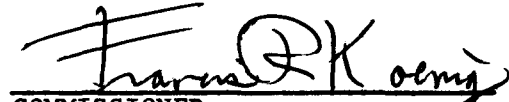
D. That the petition of Braka & Co., Inc. is hereby denied; the notices of deficiency issued on November 11, 1975 are sustained; and the Audit Division is hereby directed to process petitioner's claims for refund.

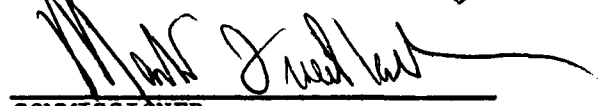
DATED: Albany, New York

STATE TAX COMMISSION

JUL 06 1984


PRESIDENT


COMMISSIONER


COMMISSIONER